CALIFORNIA BUDGET PROJECT

policy points

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CALIFORNIA'S ENTERPRISE ZONE PROGRAM: NO BANG FOR THE BUCK

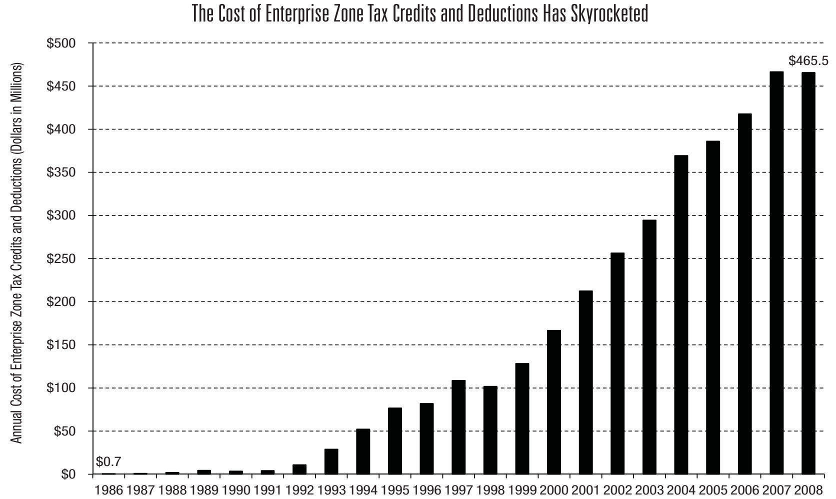
As part of his Proposed 2011-12 Budget, Governor Brown called for the elimination of tax breaks provided through California's Enterprise Zone (EZ) Program and other geographically targeted programs.[1] This proposal would generate an estimated $343 million in 2010-11, $581 million in 2011-12, and more than $600 million each year thereafter. The Legislative Analyst's Office (LAO) has recommended for years that the state eliminate or restructure EZs "because they are expensive and not strongly effective."[2] Indeed, the best available independent research finds that the state's EZ Program fails to create jobs or new businesses – key goals of the program. Yet EZ tax breaks have cost the state $3.6 billion since the program's inception, primarily benefiting less than half of 1 percent of the state's corporations – those with assets of $1 billion or more.

KEY FACTS

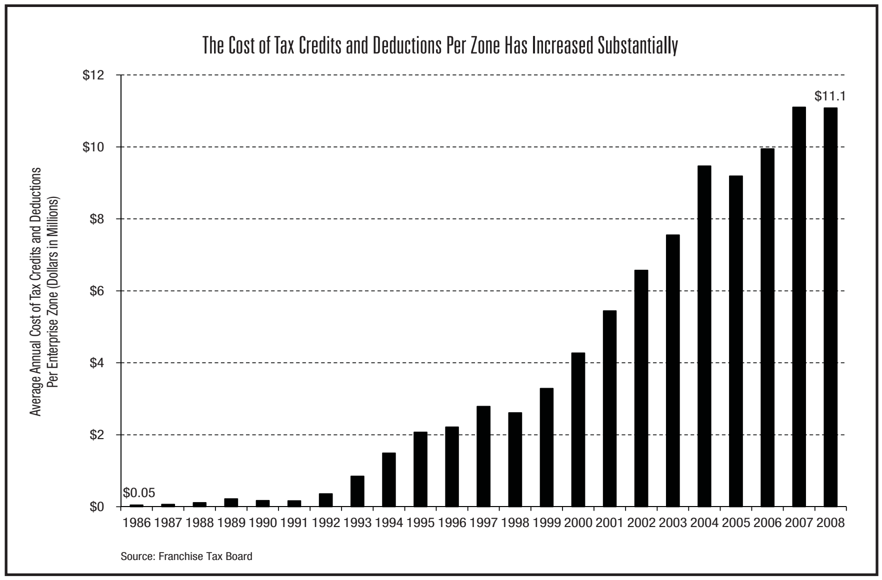
- **The cost of EZ tax credits and deductions has increased substantially since the beginning of the EZ Program.**

EZs cost the state $465.5 million in 2008, up from just $675,000 in 1986.[3] In fact, the cost of EZ tax credits and deductions has increased by 35 percent *per year,* on average, since the program's inception, for a total cost to the state of $3.6 billion. The average cost per zone has also increased substantially, from approximately $48,000 in 1986 to $11.1 million in 2008, reflecting increased use of EZ tax breaks.

The Cost of Enterprise Zone Tax Credits and Deductions Has Skyrocketed

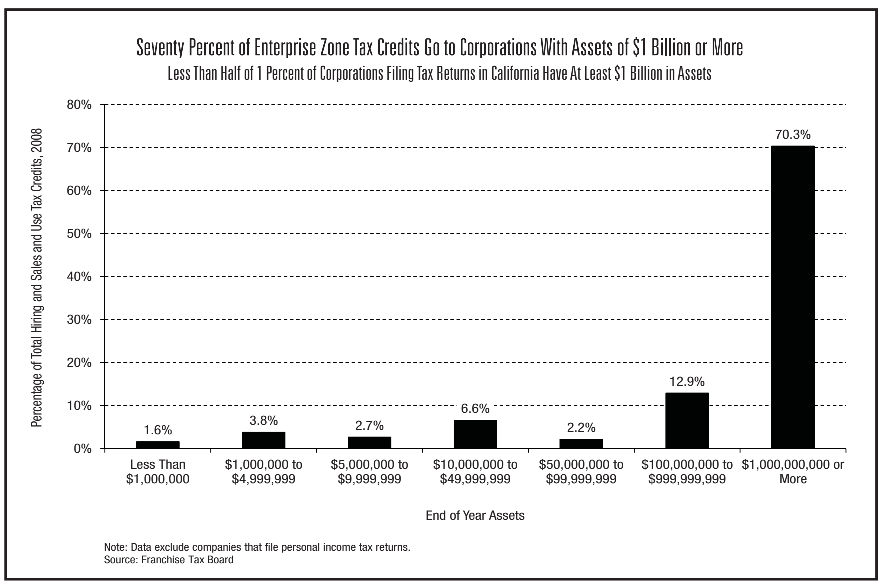


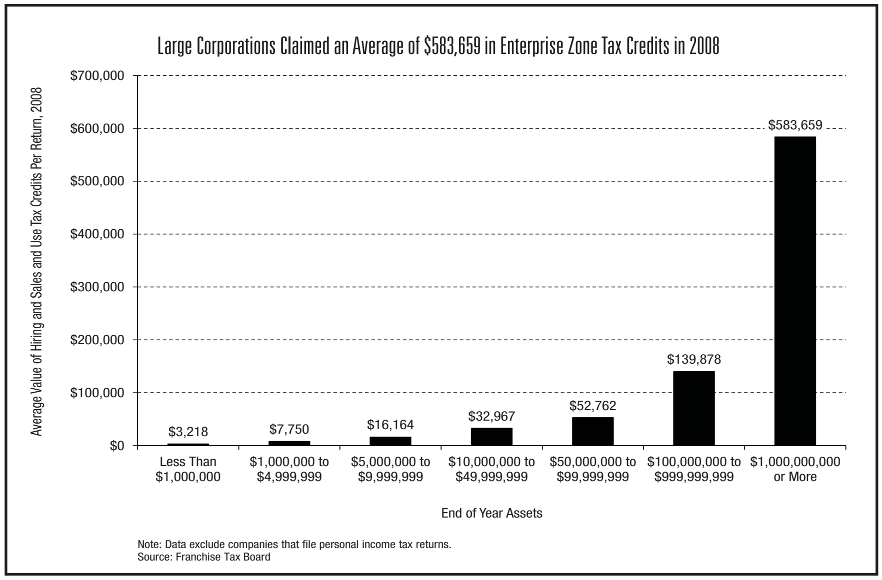
Source: Franchise Tax Board



- **Very large corporations claim most of the EZ tax breaks.**

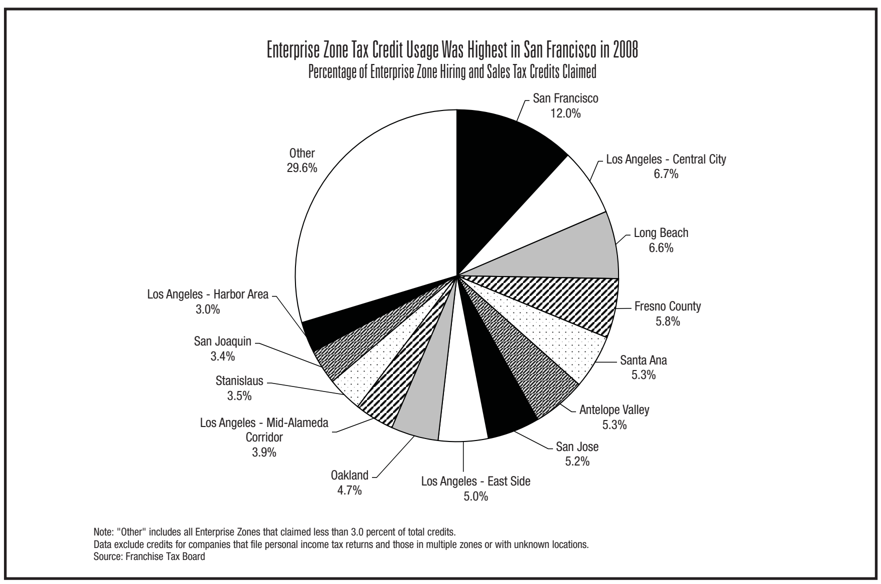
Corporations with assets of $1 billion or more claimed 70.3 percent of the total dollar value of EZ tax credits claimed by corporations in 2008, even though less than half of 1 percent of corporations that file tax returns in California have assets of $1 billion or more.[4] Nearly all of the tax credits (91.9 percent) were claimed by corporations with assets of $10 million or more, while corporations with less than $1 million in assets claimed only 1.6 percent of EZ tax credits. Thus, small businesses are not a major beneficiary of EZ tax breaks. Corporations with assets of $1 billion or more claimed an average of $583,659 in EZ tax credits in 2008, compared to $3,218 for corporations with assets of less than $1 million.





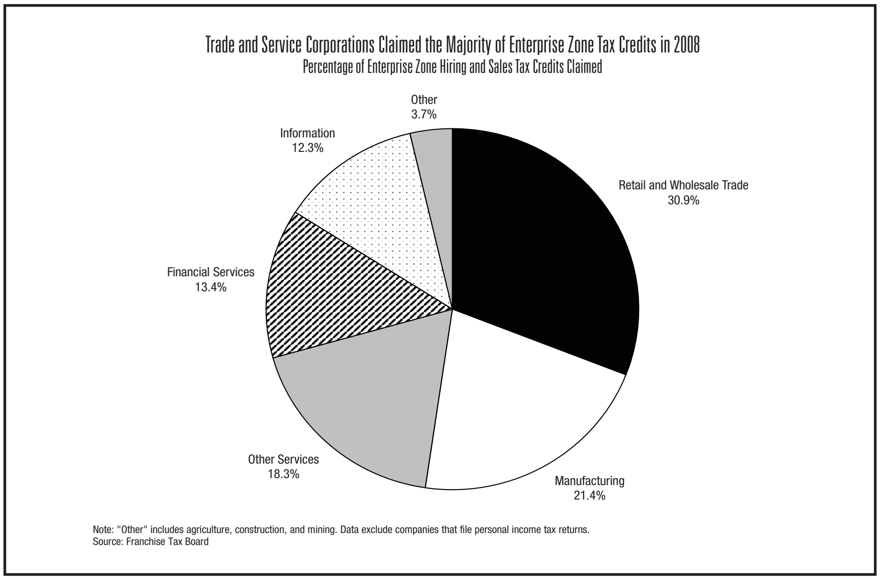
- **San Francisco corporations claim the largest share of EZ tax breaks.**

Approximately one out of eight dollars in corporate EZ tax credits (12.0 percent) were claimed by corporations in the San Francisco zone in 2008, at a total cost to the state of $25.5 million. In Los Angeles' five zones, corporations collectively claimed 20.0 percent of all EZ tax credits claimed by corporations, costing the state a total of $42.5 million. Corporations located in Long Beach, Fresno, Santa Ana, Antelope Valley, and San Jose also claimed substantial tax breaks, while those in rural areas with very high unemployment rates, such as Calexico, Delano, and Shafter, claimed relatively fewer tax breaks.



- **Trade and service corporations are heavy users of EZ credits.**

Retail and wholesale trade corporations claimed 30.9 percent of EZ credits in 2008, while other service corporations claimed 44.0 percent of credits – 13.4 percent for financial services, 12.3 percent for information, and 18.3 percent for other services. Manufacturing corporations claimed 21.4 percent of zone credits.



- **The best available independent research finds that California's EZ Program fails to create jobs.**

An extensive study by researchers at the Public Policy Institute of California found that "on average, enterprise zones have no effect on business creation or job growth."[5] Specifically, the study found that EZs "have no statistically significant effect on either employment levels or employment growth rates."[6] In addition, although the researchers do not directly assess the impact of EZs on unemployment or poverty, they argued that "it is difficult to see how these outcomes could improve in the absence of a positive effect on employment."[7] The researchers concluded that "the absence of evidence of a beneficial effect of California's enterprise zones on job and business creation clearly calls into question whether the state should continue to grant enterprise zone tax incentives."[8]

- **The LAO has recommended for years that the state eliminate or restructure the EZ Program.**

The LAO recently recommended that the Legislature approve the Governor's proposal to eliminate EZs, calling it one of several "sound, policy-based proposals" in the Governor's Proposed 2011-12 Budget.[9] In the past, the LAO has argued that "because they are expensive and not strongly effective, the area programs [EZs and other similar programs] should be eliminated or restructured."[10] The LAO concludes that "most research indicates that area programs [such as the EZ Program] have little if any impact on the creation of new employment and thus would not have a strong positive impact on the economic base of the state overall."[11]

- **The EZ hiring credit does not require the creation of new jobs.**

The high cost of the EZ Program is primarily attributable to the hiring tax credits, which cost the state $273.5 million in 2008 – 58.7 percent of the total cost of the EZ tax breaks.[12] Yet companies can claim hiring credits without creating new jobs, since the credits are for *new hires,* not *new jobs.* In other words, businesses could perpetually claim hiring credits for eligible workers who refill positions that open up due to normal turnover, without creating any new jobs over the lifetime of the EZ. In effect, the hiring credit rewards companies that create no new jobs, but have high turnover rates, more than it rewards companies that create steady employment. Moreover, since the amount of the credit declines over time, firms are encouraged to churn their workforce in order to maximize the amount of tax credits claimed.[13]

Companies can also claim hiring tax credits long after individuals begin work and even for workers who are no longer employed at a zone business, which the LAO has pointed out "provides more of a reward than an incentive."[14] By definition, retroactive credits provide bonuses for past actions, but do not encourage businesses to increase or maintain employment in future years and thus do not further program goals. Given these flaws in the program's design, it is not surprising that businesses indicate that EZ tax breaks are ineffective. Nearly half of businesses (47.1 percent) report that the EZ hiring credit "never" or "rarely" influenced their hiring decisions, and 61.5 percent report that it "never" or "rarely" played a role in deciding whether or not to retain workers.[15]

- **The majority of the hiring tax credits claimed are based on individuals' residency, not on barriers to employment.**

While EZ Program supporters claim that the program encourages employers to hire disadvantaged individuals, the overwhelming majority of approved credit vouchers – which companies must receive in order to claim the hiring credit – are for employees who merely happened to live at the right address. Nearly two-thirds (64.8 percent) of hiring credit vouchers approved by EZs in 2004 – the most recent year for which data are available – were for residents of Targeted Employment Areas (TEAs), regardless of their income or other characteristics.[16] Several other hiring credit eligibility categories also enable businesses to claim credits for workers regardless of whether they face barriers to employment.[17]

- **The EZ Program is too large to effectively direct business activity to areas most in need of assistance.**

The ability of EZs to encourage economic activity in the state's most distressed areas requires that zone designation be limited to those communities. However, EZs are so prevalent that about one out of eight California workers is employed at a business located in one of the state's zones.[18] In fact, employment within at least seven EZs represents anywhere from one-quarter to more than half of total employment in the counties in which those EZs are located.[19]

- **EZ eligibility criteria are overly broad.**

The criteria for qualifying as an EZ have varied throughout the program's existence and have at times been changed to increase the likelihood that specific areas would be granted EZ status. Current state law includes criteria that do not adequately measure an area's overall economic well-being, such as "a history of gang-related activity, whether or not crimes of violence have been committed."[20] Moreover, state law does not require EZs to substantiate economic distress to retain their original 15-year designation or expand.[21] This means that EZs can include neighborhoods that are not economically distressed. An analysis of Census tracts within the San Francisco EZ, for example, revealed that the majority of tracts failed to meet at least two economic distress criteria, as required for EZ eligibility.[22]

Alissa Anderson prepared this Policy Points *with assistance from Luke Reidenbach. The California Budget Project (CBP) was founded in 1994 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. General operating support for the CBP is provided by foundation grants, subscriptions, and individual donations. Please visit the CBP's website at www.cbp.org.*

ENDNOTES

[1] These other programs include Targeted Tax Areas, Manufacturing Enhancement Areas, and Local Agency Military Base Recovery Areas.

[2] Legislative Analyst's Office, *California's Enterprise Zone Program* (March 10, 2010), p. 5.

[3] These amounts include tax breaks claimed by businesses that file corporate income tax returns as well as businesses, such as sole proprietorships and partnerships, that file personal income tax returns.

[4] Data exclude companies that file personal income tax returns and returns with missing or negative assets.

[5] Jed Kolko and David Neumark, *Do California's Enterprise Zones Create Jobs?* (Public Policy Institute of California: June 2009), p. 1. The study analyzed employment trends in EZs from 1992 to 2004 – a period that spans ups and downs of the economy.

[6] Jed Kolko and David Neumark, *Do California's Enterprise Zones Create Jobs?* (Public Policy Institute of California: June 2009), pp. 14-15.

[7] Jed Kolko and David Neumark, *Do California's Enterprise Zones Create Jobs?* (Public Policy Institute of California: June 2009), p. 21.

[8] Jed Kolko and David Neumark, *Do California's Enterprise Zones Create Jobs?* (Public Policy Institute of California: June 2009), p. 22. In addition, the study found that "the enterprise zone program has no effect on … the share of employment in low-wage industries and the share of employment in manufacturing" (p. 17). The study also found that the number of businesses located within EZs declined, which, given that employment in EZs remained the same, implies that business establishments became larger (p. 15). Other studies of California's EZ Program tend to base their conclusions on flawed methodology. For a discussion of these issues, see David Neumark and Jed Kolko, *Do Enterprise Zones Create Jobs? Evidence From California's Enterprise Zone Program,* National Bureau of Economic Research Working Paper 14530 (Revised January 2010), pp. 1-4.

[9] Legislative Analyst's Office, *The 2011-12 Budget: Overview of the Governor's Budget* (January 12, 2011), p. 15.

[10] Legislative Analyst's Office, *California's Enterprise Zone Program* (March 10, 2010), p. 5.

[11] Legislative Analyst's Office, *California's Enterprise Zone Program* (March 10, 2010), p. 4.

[12] The Franchise Tax Board (FTB) does not report lost revenues separately for the hiring credit and the sales tax credit, but FTB staff suggest that the sales tax credit costs the state significantly less than the hiring credit. Personal communication with the FTB (March 21, 2006).

[13] The maximum value of the hiring credit begins at 50 percent of 150 percent of the minimum wage and then declines for each additional year that a worker remains at a company. Companies can claim hiring credits for individual workers for up to a maximum of five years.

[14] Legislative Analyst's Office, *California's Enterprise Zone Program* (March 10, 2010). More than 4,200 tax returns were amended for tax years 1999 through 2003 that reduced companies' tax liabilities by claiming EZ tax credits, at a total cost to the state of $169.3 million – 14.5 percent of the cost of total EZ tax breaks claimed during that period. California Budget Project, *California's Enterprise Zones Miss the Mark* (April 2006).

[15] Nonprofit Management Solutions and Tax Technology Research, LLC, *Report to the California Department of Housing and Community Development on Enterprise Zones* (August 18, 2006). These results may actually overstate the impact of the EZ Program given that businesses that value EZ tax breaks may have been more likely to reply to the survey and would have had an incentive to exaggerate the impact those tax breaks had on their decisions. See California Budget Project, *New Study Overstates Effectiveness of Enterprise Zones* (August 2006).

[16] TEA residency allows employers to claim tax credits based solely on where a worker lives and not on any objective measure of whether the individual faces a barrier to employment. A TEA can include all or part of the zone itself, as well as additional areas that may or may not be adjacent to the zone. TEAs can only include census tracts in which more than half of residents have low incomes, defined as those who have incomes at or less than 80 percent of the area median. This definition allows a zone located in an area with high incomes to include census tracts that are not economically distressed in its TEA. For example, if a zone is located in an area with a median income of $100,000, the TEA could include census tracts where more than half of the residents had incomes of $80,000 or less. See California Budget Project, *California's Enterprise Zones Miss the Mark* (April 2006).

[17] For example, businesses can claim hiring credits for "ex-offenders" – a term that is not defined and that some EZ administrators have interpreted as individuals who have committed any type of infraction, including traffic violations. In addition, EZs have used an exception in the eligibility guidelines for the now-defunct Job Training Partnership Act (JTPA) Program to approve credit vouchers for individuals without documented economic disadvantage. The Workforce Investment Act, which replaced the JTPA Program in 2000, places a high priority on "universal access" and thus a lower priority on targeting services to disadvantaged persons. See California Budget Project, *California's Enterprise Zones Miss the Mark* (April 2006), pp. 10-12.

[18] Ted K. Bradshaw, *Cost-Benefit Analysis of California's Enterprise Zone Program,* prepared for the California Association of Enterprise Zones (June 5, 2003), p. 34. Using more recent data, researchers at the Public Policy Institute of California find that the number of workers employed at businesses in EZs for which complete data were available represented 10.9 percent of total employment in the counties in which those zones were located. The researchers estimate that those EZs represented 89 percent of total EZ employment in the state. See Jed Kolko and David Neumark, *Do California's Enterprise Zones Create Jobs?* (Public Policy Institute of California: June 2009), p. 7.

[19] In addition, in at least four EZs, the number of business establishments located in each EZ represented more than one-quarter to approximately 40 percent of the total number of establishments in the counties in which the EZs were located. Jed Kolko and David Neumark, *Do California's Enterprise Zones Create Jobs?* (Public Policy Institute of California: June 2009), pp. 7-8.

[20] Government Code, Section 7072(c). Eligibility criteria also include having at least 70 percent of public school children *in the county* in which the EZ is located participating in the federal free lunch program. However, participation in this program is difficult to measure and may reflect schools' success in enrolling children in the program. Moreover, county participation rates may not reflect conditions within a particular zone, particularly in large urban counties.

[21] Once designated, large EZs can expand their geographic boundaries by 15 percent, while smaller EZs – those measuring 13 square miles or less – can expand by 20 percent.

[22] California Budget Project, *California's Enterprise Zones Miss the Mark* (April 2006), p. 15. This analysis was based on updated data from the 2000 Census. AB 1550 (Arambula, Chapter 718 of 2006) required local jurisdictions comprising EZs to revise the boundaries of TEAs within 180 days of new US Census Bureau data becoming available. See Government Code, Section 7072(i).